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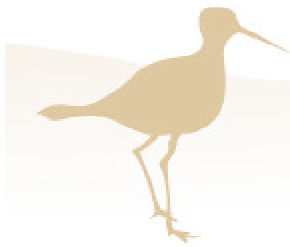
Sandpiper Capital



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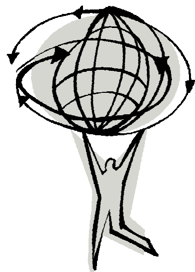


> *"In the aggregate, everything else being equal and contrary to popular belief, long run realized returns for low risk securities are as high as long run returns for high risk securities. You cannot prosper in the long run if you get your capital wiped out in the short run."*

Market Returns Annually and Through Ten Years Ending 12/31/2012

Index	2010	2011	2012	10 Yrs
S&P 500	15.1	2.1	15.9	**7.1%**
ML 1-5 yr Gov't/Corp	4.2	3.1	2.5	**3.7%**
EAFE (Dev Fgn Mkts)	7.8	-12.2	17.2	**8.2%**
Gold	29.5	10.1	7.1	**17.0%**

"What works….."

There are as many ways to manage money as there are money managers. Just brief social conversations with others in my field have revealed a variety of assumptions about how the markets work and what people consider to be appropriate investment strategies.

In my own career over the last 30+ years, I have also held a variety of assumptions about how the markets work and have used a broad spectrum of strategies. Unfortunately, with market dynamics constantly shifting, what is an appropriate strategy one year may turn out to be entirely wrong the next.

And it is certainly true that what looks like a good idea on the surface, upon deeper analysis, is often revealed to have critical problems. "Are there any market strategies that always work?" you might ask. I would say that in the long run the answer is yes, but there are routinely short periods in the market where all bets are off. Actually, knowing that is true and taking advantage of those dislocations is one strategy that does work well over all long run time frames (to date, at least).

What then, always works in the long run? Here a few strategies that I use and will continue to advocate:

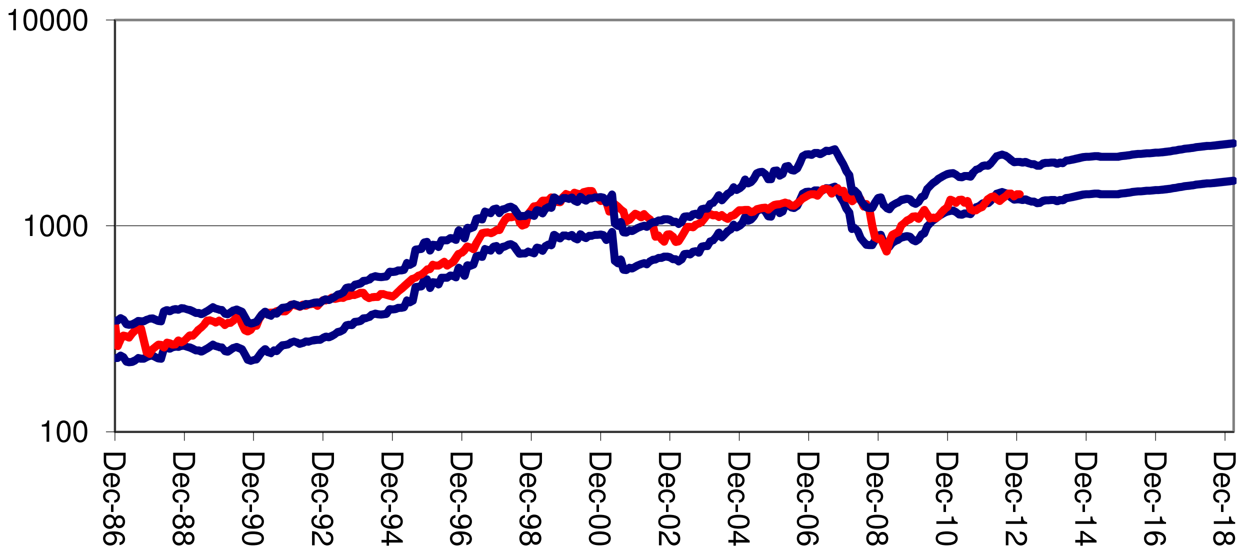
Buy for the long run. To benefit from the change in circumstances or perceptions that increase the value of your position, you need to own it long enough to see that happen. Economic and competitive cycles are measured over years. Your investment perspective should have a similar horizon.

Minimize your risks. Every investment idea comes with a list of things that could go wrong. Know as many of the important things on that list as possible and don't buy if the list is too long. Even when the markets have accounted for those risks by reflecting them in a discount in the price of a security, too many possible problems will usually result in too many realized problems. No-one can afford to weather blow after blow of bad news as eventually you lose confidence and sell, (usually just before good news takes the price higher). In the aggregate, everything else being equal and contrary to popular belief, long run realized returns for low risk securities are as high as long run returns for high risk securities. You cannot prosper in the long run if you get your capital wiped out in the short run.

Know what you can reasonably expect to happen before you buy. Optimism fueled by well documented research will help you hold or increase your position when circumstances cause optimism fueled by wishful thinking to fade. Looking back at trying periods in the past will help you know what to expect during trying times in the future. No profits doesn't always mean no income. Ebbing revenue growth may be good news if competitor's sales are declining. Knowing the low risk securities (i.e., low debt, stable competitive advantage, low operating leverage, stable positive free cash flows) that you own will give you confidence when others lose theirs.

Admit it when you're wrong. Having a clear idea of reasonable expectations does have the related benefit of allowing you to tell when those expectations aren't realized. All the care and caution in the world doesn't mean things always go well. When your reasonable assumptions prove faulty, recast them to see if the investment still makes sense and if it doesn't sell and start over.

Here again is a comparison of the S&P's monthly average price (in red) to the upper and lower boundaries that we would expect given economic fundamentals. Optimistic environments, (e.g.; 1999 -2000) push stock prices to the top of the range, pessimism drops them to the bottom of the range. Depressed incomes and then depressed home values have seriously dampened the public's enthusiasm for stocks, pegging us to the lowest end of valuations. I believe that until both recover (incomes and home prices) lifts off of that base line should prompt selling.



Green line- the lower band for our calculation of fair value for the S&P
Black line- The average monthly price for the S&P 500
Sandpiper's fair value model uses only reported earnings and reported CPI inflation in its calculations. The green line extended out to December 2013 illustrates our expectations for S&P earnings to stabilize at about $25 each quarter for the next four quarters. While typically the market does not fall below the green line, the possibility exists that bad news could push us back 120 points or so or about 8%. If last year's market holds as a model, upside is to about 1530 or up 4% from here, (1466 at this writing.)